Blank Page

FILE COPY

Blank Page

In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 371

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JOHN H. SMITH

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM IN REPLY TO PETITION FOR REHEARING

1. The petition for rehearing and the brief *amici curiae* are devoted principally to an effort to establish that in its opinion this Court misstated the facts bearing upon the subsidiary question of the time when the income should be taxed. It is claimed that "the Tax Court found that the option was exercised in its entirety * * * in March, 1938 * * *" (A. C. 2);[1] that the taxpayer then "*purchased* said stock and acquired the right to have all of such stock delivered to

[1] In this memorandum "T." refers to the petition for rehearing; "A. C.," to the brief of *amici curiae*.

638619—45

him" (T. 5.); and that the "Tax Court stated in its opinion that the petitioner received compensation when he *exercised* his option and Western parted with the right to receive stock which had a much greater value than the option price" (A. C. 4).

The Tax Court actually stated, however (R. 33)—

> When petitioner *exercised his option and received the stock* [he] * * * received compensation to the extent of the differential. * * * The basic facts are that petitioner was given an option as compensation for services and that he realized gains in the taxable years pursuant to the exercise of this option. [Italics supplied.]

With respect to the decision of the Tax Court this Court stated in its opinion (p. 3) that—

> its finding that the option was given as compensation for respondent's services, had reference to the compensation to be derived from exercise of the option after the anticipated advance in market price of the stock. *The option could be exercised only when Western's contract with Hawley had been successfully performed* * * *. [Italics supplied.]

Western did not become entitled to the shares of stock successively delivered to the taxpayer in 1938 and following years until "a day or two"

before deliveries were actually made to him. (R. 106–107, 27–28, 65–66.) It is clear, therefore, that both this Court and the Tax Court regarded the fulfillment of the conditions upon the right of Western and the derivative right of the taxpayer (R. 23–24, 25–27), as essential to effective exercise of the option. References to exercise of the option elsewhere in the opinion of this Court presumably were made in the same sense as that quoted above.

The attack on the opinion of the Court ignores the special circumstances of the case, and assumes that the opinion deals with the conventional case where the right to receive the subject matter of the option is not contingent. Our brief on the merits (pp. 25–26) detailed the reasons why the special circumstances of this case required that the income be spread over the years of delivery. The taxpayer's brief made no answer to this portion of our argument, and the contention that the excess value of the shares should be included in his income for 1938 is made for the first time in his petition for rehearing (p. 5).[2] There is no occasion for further treatment of the matter at this juncture of the case, after it has been correctly and expressly decided by this Court and the Tax Court.

[2] The taxpayer's statement of points to be relied on in the court below (R. 167–168, par. 7), contended that if he had received any income, it was only in 1934 when he received the option.

2. There can be no question as to the value of the option at the time it was given. The taxpayer conceded in his brief in opposition (p. 5) that it had no value at that time, and has never asserted the contrary.

3. The relation of the present case to *Palmer* v. *Commissioner*, 302 U. S. 63, is in no need of "clarification." The assumption (A. C. 9, *et seq.*) that the cases involved identical problems is of course not warranted by the fact that both are dealt with in the same article of the Regulations. The cases arose in different fields and on different findings of fact. The question in the *Palmer* case was whether there had been a distribution of corporate earnings; in this case it was whether the taxpayer had received compensation. Here the taxpayer was required to pay tax upon compensation regardless of the form or source of the payment. In the *Palmer* case the Board found that the corporation had no intention to make any distribution by the issuance of the warrants, and this Court, after accepting that finding, held that there was no rule of law which required that it be held a dividend notwithstanding the corporate intention. This Court recognized that in a case involving different facts the result might be different. Here the Tax Court found that the very purpose and effect of giving the option was to compensate the taxpayer, and since the source of the payment is

immaterial here, the excerpt from the *Palmer* opinion relied on (A. C. 10–11) is wholly irrelevant.

CONCLUSION

The petition for rehearing should be denied.

Respectfully submitted,

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
J. LOUIS MONARCH,
Special Assistants to the Attorney General.

APRIL 1945.

U. S. GOVERNMENT PRINTING OFFICE: 1945